



Law Society  
of Scotland

# Consultation Response

## Construction Industry Scheme Reform

20 July 2023



## Introduction

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The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

Our Tax Law sub-committee welcomes the opportunity to consider and respond to the HM Treasury and HM Revenue & Customs consultation: *Construction Industry Scheme reform*.<sup>1</sup> The sub-committee has the following comments to put forward for consideration.

### **Question 1: What are your views on including VAT in the GPS compliance test?**

We have no comments.

### **Question 2: Can you see any unintended consequences if VAT was added to the compliance test: are there barriers to submitting returns/payments in a timely manner, and could the proposal affect compliant or particular sized businesses?**

We have no comments.

### **Question 3: What channels of application are preferred, and do you envisage any challenges in shifting to digital?**

We have no comments.

### **Question 4: Are there any other changes that could be made to the scheme which would prevent abuse, while also maintaining simplicity for legitimate users?**

We have no comments.

<sup>1</sup> [Construction Industry Scheme reform - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/construction-industry-scheme-reform)

### **Question 5: Should any landlord to tenant payment be within the scope of CIS?**

We believe not. Although some L2T payments are undoubtedly within the scheme it is difficult to see how the mischief the scheme was originally created to combat – then known as “working on the lump”, whereby contractors paid sub-contractors in cash and no tax returns were ever made nor tax paid – is applicable to L2T payments.

Moreover, in practice it is difficult for landlords who are not actual contractors to monitor when they become deemed contractors by exceeding the £3m threshold. Also, tenants are often not familiar with the scheme and simply do not realise that they are sub-contractors under the scheme. The result is that landlords will have to register (and verify the status of the tenant), and tenants usually wish to register to avoid tax being deducted from their receipts at the higher 30% rate. That all takes months. Even after registration the tenant will however be unable to secure GPS as they won't have a history of construction turnover. So, even if registered, tenants will suffer withholding deductions at the lower 20% rate, which can lead to cash flow issues as they cannot recover the deductions until filing their corporation tax returns, again possibly many months later.

Finally, as explained more fully below, it is in practice difficult to draw the line between landlords' CAT A works and tenants' CAT B works, which again leads to confusion and delay.

### **Question 6: Do all landlord to tenant payments include an inducement or encouragement element?**

No, but it is very common, especially in a falling market. In a rising market it's possible that a landlord might make a payment to a tenant which is solely linked to the cost to the tenant of providing something which the landlord would normally provide – say floorboxes – but hasn't. In a falling (or even a stable) market however landlords want to preserve the capital values of their properties (and avoid breaching banking covenants based on loan-to-value ratios), which capital values are directly linked to the rents paid by their tenants. So it makes sense for landlords to make inducement payments to their tenants over and above the “floorbox-type” payments mentioned above to induce tenants to pay so-called headline rents rather than the (lower) market rents which tenants would pay in the absence of such inducements. Very often these reverse premiums made by landlords to tenants comprise an element of “floorbox-type” payments for CAT A works but also an element of pure inducement. The fact of the matter is that it's often a “horse deal” depending not on the anticipated cost of CAT A works but rather a commercial negotiation between the parties depending on their respective bargaining strengths and weaknesses.

### **Question 7: How do you identify whether a transaction includes an inducement or encouragement element?**

It follows from the above that very often you just can't, at least not exactly. Theoretically it should be possible to analyse the amount of the L2T payment which is referable to CAT A works, and the amount referable to CAT B works, and the amount which is a pure inducement. Sometimes parties attempt to do that for the purposes of the landlord being able to claim capital allowances on the amount of its contribution under ss 537 and 538 of the Capital Allowances Act 2001, or for non-tax related purposes such as deciding whether the items for which the payment is being made should be taken into account, or alternatively disregarded, at rent review. However it is common for parties not to go into that level of detail. It is also often difficult to ascertain what works are landlords' CAT A works and what are tenants' CAT B works. The floorbox example mentioned above would generally be considered to be CAT A works – but what if the tenant required extra floorboxes above the normal standard because of its particular commercial needs? Arguably the provision of the additional floorboxes would be tenants' CAT B works. So exactly the same works are partly CAT A and partly CAT B.

### **Question 8: What are the drivers for delegating building fabric works to tenants rather than landlords arranging it themselves?**

There may be several different drivers. In a fairly simple (from a construction point of view) development such as a retail park tenants often wish to take access to their unit ahead of practical completion of the overall development, so that they can fit out and be ready for trading as soon as possible after PC (which is what triggers the lease commencement date). To avoid two different construction teams getting in each other's way the landlord will pull its construction team off the job and delegate the finishing off works to the fabric to the tenant.

Again, in the case of a more complex development such as a shopping centre, many tenants, such as nationwide retail chains, will have particular requirements, particular experience and particular expertise in carrying out CAT A works which “mesh” with their own CAT B fit out works. The same applies to big logistics warehouses such as used by internet retailers like Amazon.

Also, some tenants have confidentiality at the heart of their operations, such as data centres set up by banks and other financial operators. As the servers containing confidential detail are to be introduced into the building and commissioned, again it makes sense for the tenant to carry out CAT A works so they can exclude the landlord's contractors, thus helping to avoid compromising security. And the heat generated by those servers requires specialised cooling systems (which would normally be CAT A works) with which the tenant is more familiar, so again it makes sense for the tenant to carry out these works. (And such cooling systems are another example of the practical difficulty in telling the difference between CAT A and CAT B works: while a standard air conditioning system for, say, an office would

undoubtedly be CAT A works, does the “supercharged” system for a date centre comprise, wholly or partly, CAT B works?)

**Question 9: Which of the solutions suggested is preferable?**

Amending Regulation 20 to treat all L2T payments as reverse premiums.

**Question 10: What are the advantages and disadvantages of these proposed solutions?**

The advantage of the above is simplicity coupled with the fact that the concept of reverse premiums is well known in the property industry so would be readily understood.

**Question 11: Is there a risk of creating the potential for manipulation/avoidance of the scheme by the diversion of monies via tenants?**

In our view, No. Tenants will not in practice be parties to avoidance schemes: they just want to get into their properties as quickly and easily as possible and get on with their businesses.

**Question 12: Are there groups, other than property groups, that are affected by the excessive volume of returns they are submitting to HMRC?**

We have no further comments.

**Question 13: Is a ‘grouping arrangement’ the best solution to the problem outlined and are there any elements which have not been set out?**

We have no further comments.

**Question 14: What responsibility in a ‘grouping arrangement’ should rest exclusively with the individual companies within the group and what responsibility with the nominated company?**

We have no further comments.

**Question 15: Do you see any specific anomalies which may arise in the context of CT and VAT grouping arrangements?**

We have no further comments.

**Question 16: Should the reporting of intra-group transactions be excluded on the CIS group return?**

We have no further comments.

**Question 17: Will establishing a 'grouping arrangement' impact on third party software providers?**

We have no further comments.

**Question 18: Should the process of a 'grouping arrangement' be statutorily prescribed by HMRC, and if so, to what extent?**

We have no further comments.

**Question 19: Are there any other issues you think will need to be considered?**

We have no further comments.

**Question 20: Are there areas of the CIS in terms of its scope and or administration where simplifications or improvements could be made?**

We have no further comments.

**For further information, please contact:**

Robbie Forbes  
Policy Team  
Law Society of Scotland  
0131 476 816  
[policy@lawscot.org.uk](mailto:policy@lawscot.org.uk)